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UNCLAS SECTION 01 OF 02 CANBERRA 001121

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SUBJECT: AUSTRALIAN MID-YEAR ECONOMIC UPDATE - GROWTH, SURPLUSES
DOWN

REF: A) CANBERRA 1036; B) CANBERRA 1076; C) CANBERRA 1114

¶1. (SBU) Summary. On November 5, Treasurer Wayne Swan released the Mid-Year Economic and Fiscal Outlook (MYEFO) 2008-09, the annual update to the Australian Government's budget for the 2008-2009 fiscal year, which runs from July 1 to June 30. The update lowered the estimated growth rate from 2.75% to 2.0% in 2008-09 and 2.25% in 2009-10. Tax receipts for the next four years are projected to be A\$40 billion lower due to slower growth resulting from the longer-term impact of the global financial crisis. The unemployment rate is forecast to rise from its current 4.3% to 5% by the June quarter of 2009. The projected budget surplus for 2008-2009 has been revised downward to A\$5.4 billion (0.5% of GDP) from the original estimate of A\$22.7 billion, though this includes A\$10.4 billion spent on the government's economic stimulus package (ref A). Many believe the growth figures are too optimistic. End summary.

IMPACT OF THE GLOBAL CRISIS ON THE BUDGET

¶2. (U) Budget surplus projections from the Treasury are much lower than at the time of the May budget and reflect the dramatic impact of the global financial crisis. In the MYEFO, Treasury forecasts an A\$5.4 billion surplus in 2008-09 (0.5% of GDP), down from original forecasts of A\$22 billion; the biggest hit for the current fiscal year budget is the A\$10.4 billion stimulus package announced in October (ref A). Almost all of the decrease in the predicted surplus beyond 2008-09 is due to reductions in revenue associated with the global financial crisis. Expected tax receipts have been revised down by A\$4.9 billion in 2008-09, A\$12.2 billion in 2009-10, A\$12.4 billion in 2010-11 and A\$7.9 billion in 2011-12. Revenues from capital gains taxes are expected to be significantly lower, and receipts from the company tax in 2008-09 are expected to be A\$4.5 billion lower. The complete Mid-Year Economic and Fiscal Outlook is available at: http://www.budget.gov.au/2008-09/content/myefo/download/MYEFO_2008_09.pdf

(Ignore space inserted between "09?" and "content" to satisfy cable format requirements.)

OUTLOOK FOR TRADE AND COMMODITY PRICES

¶3. (SBU) Treasury has revised downwards its outlook for commodity prices, and now predicts Australia's terms of trade will fall from its current peak levels by 8.5% in 2009-10. Prices for base metals have fallen sharply on the spot market, well below current contract prices. The depreciation of the exchange rate will dampen the falls in Australian dollar terms, but the terms of trade are expected to decline from recent peaks in 2009-10. The current account deficit is forecast to improve from 6% of GDP in 2007-08 to 4.5% in 2008-2009. Net exports are expected to subtract .5 of a percentage point from GDP growth in 2008-09 (smaller than the 1 percentage point forecast in May). The change largely reflects a weaker outlook for imports, as slowing domestic activity and a lower exchange rate act to slow demand for imports. In contrast, the

outlook for exports is slightly stronger than at Budget. The narrowing of the current account deficit reflects higher saving to GDP ratio as households rebuild their balance sheets, coupled with a slowdown in growth of national investment.

MACROECONOMIC INDICATORS

14. (SBU) The MYEFO predicts that high inflation will persist. Headline inflation recently reached 5 per cent over the past 12 months (4.8% annualized) but will moderate as global growth slows, flowing through to lower global oil and food prices. Inflation is expected to fall to 3% in 2009-10. Wages are expected to grow by 4.25% to June 2009 and will then moderate. The unemployment rate is forecast to rise to 5% by the June quarter 2009 and 5.75% by the June quarter 2010. Business investment growth is expected to slow to 5.5% in 2008-09, down from the 8.5% projected in May.

RECENT POLICY MEASURES

15. (SBU) The Rudd Government has put in place a wide range of proactive measures, including the guarantee of bank deposits (ref B) and bank wholesale funding and the A\$10.4 billion Economic Security Strategy (ref A) to protect households and financial institutions from the global financial crisis. Lower borrowing costs (interest rates have been cut 2 points over the last two months, ref C). Since the 2008-09 Budget was issued in May, total policy decisions in 2008-09 have decreased the underlying cash balance by A\$11.1 billion and the fiscal balance by A\$11.5 billion

COMMENT

CANBERRA 00001121 002 OF 002

16. (SBU) The GOA still projects growth of about 2% for the current fiscal year. We agree with many of our contacts, who suspect that this is putting a too-brave face on the situation. Discussing this on November 5, one industry association economist told econoff that he thought 1% growth was much more likely for the current fiscal year. A number of financial market analysts are even more pessimistic, with several seeing even recession as a distinct possibility, and some forecasting unemployment as high as 9%. Treasury states that the budget position has deteriorated but predicts continued surpluses. Non-government economists scoff at the notion that the budget will not go into deficit, and some are calling for deficit spending to boost the economy. Although some level of deficit spending would probably be wise in the face of a global downturn, we sense the Rudd Government may be reluctant to do so for fear of being attacked by the Opposition - even if they do maintain budgetary surpluses over the business cycle, as Treasurer Wayne Swan has carefully promised. End comment.

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